IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 44 of 1986

For Approval and Signature:

Hon'ble MR.JUSTICE A.R.DAVE Sd/-
and
Hon'ble MR.JUSTICE D.A.MEHTA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME TAX
Versus
SAURASHTRA CEMENT & CHEMICALS INDUSTRIES LTD

MR BB NAYAK FOR MR RP BHATT for Applicant.
MR BD KARIA WITH MR RK PATEL for Respondent.

CORAM : MR.JUSTICE A.R.DAVE
and
MR.JUSTICE D.A.MEHTA

Date of decision: 27/06/2001

ORAL JUDGEMENT
(Per : MR.JUSTICE A.R.DAVE)

1. At the instance of the Revenue, the Income-tax Appellate Tribunal, Ahmedabad, Bench "C" has referred to this Court, for its opinion, the following questions of law under the provisions of section 256(1) of the Income-tax Act,1961 (hereinafter referred to as 'the Act').

"(i) Whether, the Tribunal has not erred in law and on facts in holding that the amount of Rs.8,50,000/- received by the assessee was not taxable as revenue receipt in the hands of the assessee.

(ii) Whether the finding of the Tribunal that the receipt relating to liquidated damages cannot be treated as a revenue receipt but must be held to be a capital receipt not exigible to tax is correct in law ?

(iii) Whether, the assessee is entitled to the addition made to the machinery during the year while determining the capital employed for the purpose of claim u/s. 80J of the I.T.Act, 1961 ?"

2. The facts giving rise to the present Reference in a nutshell are as under.

3. The respondent assessee had entered into an agreement with M/s.Walchandnagar Industries Limited, Bombay whereunder certain machineries were to be purchased by the respondent assessee for Rs.1,70,00,000/-. As per the contract entered into between the assessee and the supplier of the machinery, the amount of consideration was to be paid by the assessee to the supplier in the following manner.

10% of the total price was to be paid on 1/4/1967 to the supplier in advance.

20% of the total price was to be paid within six months from the date of letter of intent.

65% of the price at the time of delivery of the documents pertaining to the machineries through bank.

5% of the price was to be paid on the acceptance

of the plants and machineries upon having satisfaction of performance of the machineries installed.

4. In the agreement which had been entered into by the assessee with the supplier, a provision was made with regard to the manner in which the machinery was to be delivered and with regard to the consequences of delayed delivery. As we are concerned with the delivery of the machine, clause No.6 pertaining to the delivery, incorporated in the contract entered into between the parties dated 1-9-1967 is reproduced hereinbelow :

"6. xxx xxx xxx

Delayed Deliveries :

In the event of delays in deliveries except the reason of Force Majeure at para 5 mentioned above, the Suppliers shall pay the Purchasers an agreed amount by way of liquidated damages without proof of damages actually suffered at the rate of 0.5% of the price of the respective machinery and equipment to which the items not delivered relate, for each month of delay in delivery completion. It is further agreed that the total amount of such agreed liquidated damages shall not exceed 5% of the total price of the plant and machinery."

5. Thus, as per the terms incorporated in the agreement, the assessee was to be compensated in the event of delay caused in delivery of the machinery which was to be supplied to the assessee. As stated hereinabove, without any proof with regard to the damage suffered by the assessee, the damages were to be paid to the assessee by the supplier. Thus, for delay of each month, 0.5% of the price of the respective portion of the machinery, which was not delivered, was to be paid by way of damages by the supplier to the assessee. The total amount of damages was not to exceed 5% of the total price of the plant and machinery.

6. The plant and machinery could not be supplied to the assessee in time and, therefore, as per the terms of the contract, the assessee had received a sum of Rs.8,50,000/- by way of damages from the supplier of the machinery. Looking to the facts stated hereinabove, it is to be decided whether the amount of damages received

by the assessee was a capital receipt or a revenue receipt. Another question is whether the assessee was entitled to claim deduction u/s.80J of the Act in respect of the value of the additional machinery purchased by the assessee during the assessment year in question.

7. According to the assessee, the sum of Rs.8,50,000/- received by it by way of damages was a capital receipt but as the Assessing Officer treated the said receipt as a revenue receipt, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) but the said appeal was dismissed. Being aggrieved by the dismissal of the appeal by the CIT (Appeals), the assessee approached the Tribunal by way of an appeal. The Tribunal allowed the appeal and held that the said amount was not a revenue receipt but was a capital receipt.

8. We have heard learned Advocate Mr.B.B.Nayak appearing for the revenue. It has been submitted by him that the Tribunal was in error in considering the said amount of Rs.8,50,000/- as a capital receipt. It has been submitted by him that the assessee was given the said amount because the assessee received the machinery in question late. On account of late delivery of the machinery, the plant could not be installed and commissioned as per the Schedule and, therefore, it resulted into loss in profit. So as to compensate the assessee, the said amount of liquidated damages was agreed to be paid by the supplier to the assessee and as the said amount was for compensating the loss in profit, according to learned Advocate Mr.Nayak, the said amount should be treated as a revenue receipt.

9. Learned Advocate Mr.Nayak has drawn our attention to the second portion of the clause having sub-title "delay in deliveries" and has submitted that it was agreed between the assessee and the supplier of the machinery that if the plant was not erected and commissioned on account of delay, the supplier was to compensate the assessee by paying liquidated damages. Learned Advocate Mr.Nayak has, therefore, submitted that on account of late commissioning of the plant, the assessee could not commence the production as per its Schedule and thereby suffered a loss in its profits and, therefore, the supplier had paid the amount of liquidated damages to the assessee so as to compensate it in the matter of loss of profit and, therefore, the said amount of damages should have been treated as a revenue receipt.

10. On the other hand, learned Advocate Mr.Bhargav

Karia, appearing for the assessee, while supporting the order passed by the Tribunal, has submitted that the amount of liquidated damages which the assessee had received was not for the purpose of compensating loss in profits or on account of delayed erection of the plant. It has been submitted by him that time was an important aspect in the contract with regard to purchase of the machinery and as the portion of the purchase price was to be given by the assessee to the supplier even before getting possession of the machinery in question, the supplier had to be put to terms by the assessee as substantial capital of the assessee was to be blocked up. He has drawn our attention to the fact that almost 30% of the purchase price i.e. 30% of Rs.1,70,00,000/- had been paid by the assessee to the supplier even before getting possession of the machinery. According to Mr.Karia, the said amount was lying with the supplier without giving any return to the assessee and time was essence of contract. As the delay in supply of the machinery had adversely affected the assessee, the amount of liquidated damages was given by the supplier to the assessee. It has been submitted by him that the delay caused in delivery of the plant and machinery had a nexus with the capital asset, and, therefore, the amount which had been received by the assessee was in the nature of a capital receipt and it was not a revenue receipt. He has also submitted that the assessee was not dealing in capital assets viz. the machinery which was purchased by it from the supplier. The machinery was a capital asset for the assessee i.e. a profit earning apparatus and as it had no nexus with profit earning process, the said amount of liquidated damages cannot be treated as a revenue receipt.

11. Learned Advocate Mr.Karia has relied upon the ratio of the judgment delivered in the case of E.I.D.Parry Ltd. Vs. Commissioner of Income-Tax, 233 I.T.R.335, and has submitted that when there is a delay in supply of capital goods or completion of erection of the plant and if any amount by way of compensation is given by the supplier of the plant, the amount so received is to be treated as a capital receipt.

12. We have heard the learned Advocates at length and have also perused the relevant provisions incorporated in the contract entered into between the assessee and the supplier of the plant and machinery.

13. Upon perusal of condition No.6, which pertains to

delay and delayed delivery with regard to the machinery or its parts, it is very clear that in the event of any delay being caused in supply of the machinery, the supplier was bound to pay liquidated damages without any proof of damage being actually suffered by the assessee at the rate of 0.5% of the price of the part of the machinery which had not been delivered in time, for the delay of every month. The said amount of liquidated damages was not to exceed 5% of the total price.

14. It is not in dispute that the amount of damages, which has been received by the assessee, is on account of delay caused in supply of machinery. The machinery which the assessee had purchased was a capital asset so far as the assessee is concerned. As the amount of damages received by the assessee had direct nexus to the delay caused in delivery of the capital asset, in our opinion, it cannot be said that the amount of compensation or damages, which was received by the assessee, was a revenue receipt. Learned Advocate Mr.Nayak has made efforts to show that the amount of damages was paid because of delay in production but the said submission is not supported by the terms of the contract referred to hereinabove. If it can be established that the amount of damages was paid on account of the delay caused in initiating the process of manufacture and it was on account of loss in profits, we could have accepted the submission made by learned Advocate Mr.Nayak appearing for the revenue. In fact, as can be seen from the terms of the contract, the liquidated damages are measured having regard to time (i.e. period of delay) and price of machinery.

15. In our opinion, the Tribunal was justified in coming to the conclusion that payment of liquidated damages was closely linked with the supply of machinery i.e. a capital asset. The amount of liquidated damages received by the assessee represented a source of income, and, therefore, the said amount could be said to be connected only with a profit making apparatus rather than a receipt in course of profit earning process. Thus, in our opinion, the Tribunal was absolutely justified in coming to the conclusion that the receipt of liquidated damages was not a revenue receipt in the hands of the assessee. In our opinion, it is extremely difficult to hold that the receipt in the nature of liquidated damages by the assessee had any connection with loss in profits because the capital asset viz. the machinery had not been installed at all at the relevant point of time.

16. It is also pertinent to note that there is a separate clause in the agreement which pertains to compensation to be paid by the supplier to the assessee towards loss of profits after installation of the machinery. If after installation of the machinery, on account of some difficulty in the performance of the machinery any loss had been caused to the assessee and if the said loss had been compensated by payment of damages, liquidated or otherwise, the compensation so received could have been said to be a revenue receipt because in that event the assessee was to receive some amount so as to compensate its loss in profits but that is not the case here.

17. For the foregoing reasons, we are of the view that the Tribunal was absolutely justified in coming to the conclusion that the amount of liquidated damages received by the assessee was not a revenue receipt and the Assessing Officer was in error in considering the said amount as a revenue receipt. For the aforesaid reasons, we answer the first two questions referred to this Court in the affirmative i.e. in favour of the assessee and against the revenue.

18. So far as the third question is concerned, it pertains to the benefit u/s.80J of the Act in respect of additional investment made by the assessee during the assessment year. Learned Advocate Mr.Nayak has fairly submitted that so far as the third question is concerned it has been concluded in favour of the assessee. This Court, in the case of Commissioner of Income Tax Vs. Elecon Engineering Co.Ltd., 104 I.T.R.510, has decided that the assessee in such a case is eligible to claim benefit under the provisions of section 80J of the Act. The said view has been confirmed by the Hon'ble Supreme Court in the case of Commissioner of Income Tax, Gujarat Vs. Elecon Engineering Co.Ltd., 167 I.T.R.639. In the circumstances, the third question is also answered in the affirmative i.e. in favour of the assessee and against the revenue.

19. The Reference is answered accordingly with no order as to costs.

Sd/- Sd/-
(A.R.Dave, J) (D.A.Mehta, J)

m.m.bhatt